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Ms. Jennifer J. Johnson
Secretary of the Board
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.,
Washington, D.C. 20551

RE: Docket No. R-1210

The Credit Union National Association (CUNA) is pleased to respond to the Federal Reserve Board's (Board's) proposed revisions to Regulation E and the official staff commentary. The proposed revisions to Regulation E address coverage of electronic check conversion services and include requiring persons that make electronic check conversion services available to consumers to obtain the consumer's authorization for the electronic fund transfer. Additionally, payroll card accounts that are established by an employer to provide employee compensation on a recurring basis would be considered accounts and be covered by Regulation E.

By way of background, CUNA is the largest natural credit union trade association representing approximately 90 percent of the 9,400 state and federal credit unions in this country. This letter was prepared under the offices of CUNA's Payment Systems Subcommittee, which is chaired by Lindsay Alexander, President and CEO of National Institutes of Health FCU, Rockville, Maryland.

Summary of CUNA's Position

- CUNA generally supports the proposed revisions to Regulation E, which provide additional guidance regarding the rights, liabilities and responsibilities of parties that are engaged in electronic check conversion (ECK) transactions.
- The proposed comment requires payees to obtain authorization for an electronic transfer. Authorization would be given when the consumer receives notice that the transaction will be processed as an electronic fund transfer (EFT) and goes forward with the transaction. CUNA supports the proposed requirement to provide notice to consumers authorizing the transaction.
- CUNA supports the proposal that a notice would have to be provided for each transaction. However, we do not agree that including language specifying clearing times benefits the consumer. In light of Check 21, there will be situations in which paper checks may clear as quickly or even

quicker than an EFT thereby misleading the consumer. Additionally, language stating that checks used in ECK transactions may not be returned by the financial institution may lead to confusion as the majority of credit unions currently do not return paid share drafts to their membership.

- CUNA supports the proposal to allow a single authorization for multiple checks submitted for payment after receiving an invoice or during a single billing cycle for ARC transactions. CUNA would like additional clarification that the single authorization applies to all checks received during the billing cycle, not just those checks specifically applied to a minimum payment amount.
- CUNA is concerned with the proposed amendment that would revise the error resolution section of the financial institutions' initial Regulation E disclosures to instruct consumers to notify them if unauthorized EFTs occur using information from the consumers' check. This may be misleading to consumers because consumers may believe the error resolution section only applies to ECK transactions instead of all types of transactions that are currently listed in the same initial disclosure.
- CUNA supports the proposal to withdraw the interpretation that a tape recording of a telephone conversation with a consumer who agrees to preauthorized debits does not constitute written authorization. However, we believe that this may lead to a possible increase in deceptive telemarketing practices, and suggest restricting telephone-recorded authorizations to those with whom an existing relationship exists or to those calls initiated by the consumer.
- CUNA disagrees with the revision to the regulation that would include payroll card accounts as accounts that are covered under Regulation E. Because these accounts can be operated or managed by someone other than the consumer, it is contrary to the purpose of the Electronic Fund Transfer Act to include them within the scope of Regulation E. The act is applicable to natural persons owning accounts established principally for personal, family, or household purposes.
- CUNA agrees that the six months following the adoption of the final rule is sufficient to enable financial institutions to implement the necessary changes to comply with the final rule, but believe this is not enough time to include payroll card accounts under Regulation E. Credit unions would need additional time to address certain operational problems, such as locating employee addresses.

Discussion

Electronic Check Conversion

The Board is requesting comments on its proposal to provide additional guidance regarding the rights, liabilities, and responsibilities of parties that are engaged in electronic check conversion (ECK) transactions. In an ECK transaction, a consumer provides a check to a payee and information from that check is used to initiate a one-time electronic funds transfer (EFT) from the consumer's account. The Board is proposing to revise the regulation to include guidance on Regulation E coverage of ECK transactions. Regulation E coverage of ECK transactions would be predicated on the use of the consumer's check as a source of information by a payee to initiate a one-time EFT. Currently, the guidance is contained in the official staff commentary.

The Board is proposing to clarify that ECK transactions are a new type of transfer and require financial institutions to list ECK transactions as a separate type of transfer in their initial Regulation E disclosures. The Board is providing model clauses for the initial disclosures. We support this clarification, noting that many financial institutions included this language in their disclosures when the Board amended the Regulation E official staff commentary in March 2001.

The Board is also proposing to require financial institutions to amend the error resolution section of their initial disclosures. This amendment would specifically instruct consumers to notify their institution if unauthorized EFTs occur using information from the consumer's check. We believe this additional language may be misleading to consumers because consumers may assume the error resolution section only applies to ECK transactions instead of all types of transactions that are currently listed in the same initial disclosure. All types of EFT transactions are currently listed in the same disclosure, but if the error resolution section only lists ECK transactions, consumers may believe that they only have error resolution rights for ECK transactions. By omitting the specific type of transaction in the error resolution section, consumers will recognize that the error resolution section will apply to all the transactions previously listed in the same disclosure.

Additionally, the proposal would require payees, such as merchants and financial institutions (to the extent they initiate EFTs) that make ECK services available to consumers to obtain authorization for the electronic transfer. The Board is seeking comments on whether merchants or other payees should be required to obtain a consumer's written, signed authorization to convert checks received at the point of sale. We do not believe that obtaining written authorization from a consumer should be required under Regulation E. Currently, the NACHA rules governing point of sale transactions already require written authorization. Regulation E is duplicating this requirement, and we believe the NACHA rules should define this provision, as there is no statutory requirement to include it in Regulation E. Additionally, it may be more difficult to alter and amend rules through the Federal Reserve's rulemaking process. Rather than require payees to obtain consumers' written authorization, we support the proposed comment that states that a consumer authorizes a one-time EFT when the consumer receives notice that the transaction will be processed as an EFT and goes forward with the transaction.

If a payee also intends to collect a fee for insufficient funds electronically, the Board is proposing to require the payee to disclose that the consumer authorizes the payee to collect the fee as an EFT. We support this disclosure.

The Board is proposing that a notice would have to be provided for each transaction and a generic statement posted on a sign or a written statement at point of sale or provided with a billing statement or invoice that is clear and conspicuous would fulfill the requirement. We support the proposed requirement to provide notice to consumers authorizing this transaction. The notice would state that when the transaction is processed as an EFT, the funds may be debited from the consumer's account quickly. We believe that language specifying clearing times should not be included in the notice because clearing times vary and with Check 21 in effect, there will be situations in which paper checks may clear as expeditiously or even faster than ECK transactions thereby misleading the consumer.

The notice would also state that the financial institution would not return the consumer's paid checks. This clause would not be required if the merchant returns the consumer's check at point of purchase (POP) transactions. We believe this statement may lead to confusion and therefore will not benefit the consumer. Currently, approximately 94% of credit unions truncate checks and therefore do not return paid share drafts to their members. By stating that a consumer's check may not be returned when used in ECK transactions, a consumer may mistakenly believe that his or her checks will be returned when not used in ECK transactions.

There may be situations in which a consumer's check cannot be verified by the financial institution, which would prohibit the payee to complete the transaction as an EFT. The proposal is seeking comment on whether notices for authorization of an ECK transaction must specify the circumstances in which a check would be processed as a paper transaction. Specifically, the proposal provides three model clauses regarding the notices for authorization of ECK transactions. The first notifies that the transaction will be processed as either an EFT transaction or check transaction, the second notifies that the transaction will be processed as an EFT, and the third notifies that the transaction will be processed as an EFT or a check and also outlines the circumstances under which it will be processed as a check transaction. The Board is seeking comment on whether all three clauses should be retained in the final rule. We believe that the final rule should make optional the disclosure outlining the circumstances under which a payee processes the transaction as a check transaction. The list of circumstances may become lengthy and not practical to the consumer at the point of sale or on a bill.

In its proposal, the Board would allow payees to obtain a single authorization for ARC transactions by a consumer holding an account to convert multiple checks submitted as payment after receiving an invoice or during a single billing cycle.

We believe that an accountholder receiving notice of check conversion would be given sufficient notification of the conversion. Additionally, converting all checks in the billing cycle without requiring authorization for each check submitted would facilitate payees' check processing. We would like additional clarification that the single authorization applies to all checks received during the billing cycle, not just those checks specifically applied to a minimum payment amount.

Payroll Card Accounts

The Board is proposing to revise the regulation to include "payroll card accounts" as accounts that are covered under Regulation E. Payroll card accounts are accounts that are established at a depository institution in which employees' salaries are periodically deposited and held on their behalf. Employees are issued a card that they can use to access their funds electronically.

We oppose including payroll card accounts in the definition of "account" for purposes of Regulation E. The Electronic Fund Transfer Act is applicable to natural persons owning accounts established principally for personal, family, or household purposes. By including in the definition of "account" a payroll card account that can be operated or managed by the employer, a third-party payroll processor, or a depository institution, the proposed definition may imply that the employer, third-party payroll processor or depository institution controls or owns the account, which is contrary to the purpose of Electronic Fund Transfer Act.

Additionally, other regulations covering deposit accounts, such as Truth in Savings rules and Regulation D, are silent on the issue of whether payroll card accounts specifically, or accounts underlying stored value cards generally, apply. The Board's proposed treatment of payroll card accounts may create confusion among consumers and financial institutions in light of that. We request that if the Board considers future proposed regulations, it work with the financial institution groups and regulators to develop consistent regulations governing stored value card accounts, including payroll card accounts and gift card accounts.

Credit unions are also concerned about the ability to comply with certain provisions of Regulation E, such as providing initial disclosures and periodic statements, to those consumers who hold payroll card accounts but are not members. Typically, payroll card accounts are established by an employer and the funds may be held in one account. In this type of account, the customer relationship is between the credit union and the employer. As such, the depository institutions may find it difficult, if not impossible, to obtain addresses of individual employees holding payroll cards making compliance with certain Regulation E provisions unattainable.

Currently, the Federal Deposit Insurance Corporation (FDIC) is considering whether the funds in payroll card accounts qualify for deposit insurance. The Board is specifically seeking comments on whether Regulation E coverage for payroll card accounts be determined by the FDIC's decision. We do not believe that Regulation E coverage should be contingent on the funds being insured. The Electronic Funds Transfer Act and Regulation E provides rights and protections to consumers in the electronic fund transfer system. Consumers should be afforded rights and protections regardless of whether the funds in the accounts are federally insured.

Preauthorized Transfers

Current commentary states that a tape recording of a telephone conversation with a consumer who agrees to preauthorized debits does not constitute "written authorization" under Section 205.10 (b), which requires a consumer's written authorization. The Board is proposing to withdraw this interpretation as it may conflict with the E-SIGN Act. We support this action but are concerned about a possible increase in deceptive telemarketing practices, because tape recordings may not record an entire conversation omitting deceptive sales pitches. This may expose consumers to fraud. This may lead to increased member concerns and stop payment requests to financial institutions. Therefore, we encourage the Board to consider restricting telephone-recorded authorizations to those with whom an existing relationship exists or to those calls initiated by the consumer.

Effective Date

The Board is seeking comment on whether six months following the adoption of the final rule is sufficient to enable financial institutions to implement the necessary changes to comply with the final rule. We believe this is sufficient time to comply with the electronic check conversion provisions, but believe this is not enough time to include payroll card accounts under Regulation E. Credit unions would need additional time to address certain operational problems, such as locating employee addresses. Additionally, if the Board chooses to adopt as final including "payroll card accounts" as "accounts" covered under Regulation E, there would be confusion among financial institutions about the applicability and extent of coverage under other regulations governing deposit accounts.

Conclusion

We generally support the proposed amendments to Regulation E, which provide rights and protections to consumers. If you have any further questions, please contact CUNA's Senior Vice President and Associate General Counsel Mary Dunn or me at (202) 638-5777.

Sincerely,

Lilly Thomas
Assistant General Counsel